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Fed Cuts Key Rate as Stimulus Plan Advances

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WASHINGTON — The Federal Reserve cut short-term interest rates on Wednesday for the second time in eight days, meeting Wall Street hopes for cheaper money. At the same time, the Senate pushed ahead on a $161 billion plan to prop up Main Street with tax rebates and temporary tax cuts.

In lowering its benchmark federal funds rate by half a percentage point, to 3 percent, the central bank signaled that it was ready to err on the side of boldness in fending off a possible recession. It also left open the possibility of additional rate cuts.

The Fed’s move was part of a one-two punch by Washington aimed at jolting the economy with easier credit and extra money. Senate Democrats advanced a fiscal stimulus bill that could inject $161 billion into the economy this year through tax rebates for individuals and tax breaks for businesses.

If anyone needed more evidence that the economy is stumbling, it came just hours before the Fed announced its decision. The Commerce Department reported that the economy went into a stall in the last quarter of 2007, estimating that growth slowed to an annual rate of 0.6 percent, from 4.9 percent in the third quarter.

Despite some disagreement, all the major power centers in Washington — the White House, Congress and the Federal Reserve — agree about the need to bolster the economy with both fiscal and monetary policy.

The Senate Finance Committee passed a stimulus package on Wednesday that was more expensive than one the House passed on Tuesday, but only three Republicans on the panel voted for it, a signal that bipartisan cooperation may be faltering.

President Bush, in a speech at the Robinson Helicopter Company in Los Angeles, repeated his call for the Senate to move fast. “I understand people having their points of view, and of course, we welcome points of view in Washington,” he said. “There appears to be a lot of them up there.”

The big rate cut prompted a rally in stocks, with the Dow Jones industrial average jumping more than 100 points immediately after the Fed announcement. But relief was quickly overshadowed by anxiety about another wave of potential losses tied to subprime mortgage defaults.

The major stock indexes ended the day slightly below where they had started after reports that credit-rating agencies were poised to lower their ratings on companies that insure bonds containing packages of mortgages.

Many economists are far from convinced that even a combination of tax rebates and cheaper money would prevent a recession. And in a sign that bond investors are fretting that the moves could lead to higher inflation, yields on 10-year and 30-year Treasury securities edged up slightly on Wednesday.

But both Congress and the Fed were under heavy pressure to provide reassurance to their respective constituencies.

Noting that “downside risks remain,” Fed officials said in a statement accompanying their rate decision that they would “act in a timely manner as needed to address those risks.”

The Fed’s action was its second big rate reduction in eight days and its fifth rate cut since September. The central bank has reduced overnight lending rates by 1.25 percentage points since Tuesday of last week and by 2.25 percentage points since August.

By comparison, under its former chairman, Alan Greenspan, the Fed reduced the overnight rate by only half a percentage point after the terrorist attacks on Sept. 11, 2001, though it eventually pushed its benchmark rate as low as 1 percent in 2003 to encourage an economic recovery.

The Fed’s move on Wednesday came after an even bigger surprise rate cut of three-quarters of a percentage point on Jan. 22 at a rare unscheduled meeting.

Among investors, the big uncertainty was whether Ben S. Bernanke, the Fed chairman, would persuade his colleagues to cut rates by one-half point or just one-quarter. Investors were betting heavily that the Fed would make the bolder choice, and many analysts predicted investors would pummel stock prices if the Fed disappointed them.

But Fed officials were already under fire from investors and analysts on Wall Street who complained that the Fed had responded too timidly to signs of a downturn, and from a small but significant number of economists who complained that policy makers were being pushed by the stock market into rash decisions.

The decision by the Fed's policy-making committee provoked a dissenting vote, by Richard W. Fisher, president of the Federal Reserve Bank of Dallas. He favored no change in rates, but other well-known skeptics about rate reductions voted in favor.

"The message came through loud and clear that they are embracing the need for an accommodative monetary policy," said Robert V. DiClemente, an economist at Citigroup.

But while many analysts praised Mr. Bernanke and the Fed, some said the Fed had become unpredictable and might end up acting capriciously.

While it is clear that economic growth has slowed sharply, the evidence of a looming recession is still ambiguous. Housing construction and home sales have both plunged by more than half over the last 12 months, and home prices are declining in most parts of the country.

Retail sales were sluggish during the crucial holiday season, but the government estimated on Wednesday that consumer spending climbed at a modest but respectable pace of about 2 percent in the fourth quarter of 2007.

Job creation slowed to a crawl in December, according to the Labor Department's preliminary estimate. But many analysts now predict that the Labor Department, which reports on Friday about January employment, will estimate that the nation added about 100,000 jobs this month.

Inflation, meanwhile, is running higher than Fed officials would like. In its report on Wednesday about economic growth in the fourth quarter, the Commerce Department estimated that consumer prices, excluding energy and food, climbed at an annual pace of 2.7 percent. The Fed's unofficial comfort zone for inflation is 1 percent to 2 percent.

Congressional leaders were focused on how they could add to what the Fed was already doing.

The stimulus bill approved by the Senate Finance Committee Wednesday would cost $157 billion in 2008 and $193 billion over two years, roughly $32 billion more than the bill the House passed on Tuesday.

At the very least, the effort by Senate Democrats to advance their own plan would create some delay in getting a bill to the White House for the president's signature, because it would require Senate and House leaders to reconcile different plans.

Both the House and Senate proposals offer tax rebates and business incentives to encourage spending. The Senate package would provide tax rebates of up to $500 for individuals and $1,000 for couples, to be phased out for incomes over $150,000 and $300,000, respectively. It would also provide a minimum payment of $500 for all tax filers reporting at least $3,000 in income, and an additional payment for families of $300 per child.

The Senate plan is more expensive than the House's in part because it would provide a $500 check to some 20 million elderly whose only income is from Social Security and to about 250,000 veterans living on government benefits. The Senate package also includes a 13-week extension of unemployment benefits.

But the tepid support among Republicans on the Finance Committee created uncertainty about whether the Democrats, who enjoy only a narrow majority in the Senate, could win the 60 votes they need to avoid a filibuster and bring the bill up for a vote.

A more immediate obstacle to bringing the stimulus package to the Senate floor was Republican insistence that the Senate first reach an agreement on renewing the Bush administration's terrorist surveillance program, which is a major priority for the White House. Aides said that Mitch McConnell, the Republican leader, wanted assurances that the Senate would vote to extend the foreign surveillance program.

Senator Harry Reid, the majority leader, said on Wednesday such a deal was within reach, but he called a special meeting of Democratic senators for 10 a.m. Thursday to discuss the surveillance bill and the stimulus plan, indicating that the fate of those bills was now linked.